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Exemption from federal estate duty of bequests...

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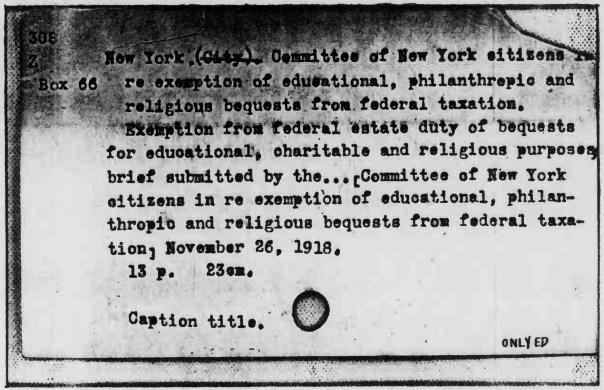

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New York (City). Committee of New York citizens re exemption of educational, philanthropic and religious bequests from federal taxation.

Exemption from federal estate duty of bequests for educational, charitable and religious purposes; brief submitted by the...[Committee of New York citizens in re exemption of educational, philanthropic and religious bequests from federal taxation], November 26, 1918.

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# Exemption from Federal Estate Duty of Bequests for Educational, Charitable and Religious Purposes.

**Brief Submitted by the National Committee, Representatives of Educational, Charitable and Religious Institutions in re Tax Exemption of Bequests and Legacies for Philanthrophy, November 26, 1918**

*To the Finance Committee of the United States Senate, and*

*To the Ways and Means Committee of the House of Representatives:*

The following considerations are respectfully submitted in favor of the exemption from Federal Estate Duty of bequests for educational, charitable, or religious purposes:

## Brief History of the Existing Law.

The Federal Estate Tax Law of September 8, 1916, imposed a progressive tax upon the estates of decedents, the rate of tax being determined by the value of the whole net estate, and reaching a maximum rate of ten per cent. upon the amount by which the net estate exceeds $5,000,000.

By the Act of March 3, 1917, this scale of rates was increased fifty per cent., so that a maximum rate of fifteen per cent. was reached upon all amounts in excess of $5,000,000.

The Act of October 3, 1917, imposed an additional graded tax reaching the rate of ten per cent. upon all amounts by which the net estate exceeds $10,000,000.

By the existing Federal law, therefore, the estate of every decedent is subjected to a graduated tax which reaches fifteen per cent. at $5,000,000, and an additional graduated tax which reaches a ten per cent. rate at $10,000,000.

Under these statutes there is an exemption of $50,000 for each estate.

While the tax imposed by these laws falls within the general class of "Inheritance Taxes" it differs materially

from the taxes of that class which have been generally in force in this country, in that the rate of tax is determined, not, as is substantially the universal custom, by the amount received by the several heirs or legatees respectively, but by the amount or value of the entire estate; with the result that the tax imposed is much heavier than that which would be produced by the ordinary "Inheritance Tax," with a similar schedule of percentage rates.

In neither of these Federal Acts is there any provision for the exemption of gifts for educational, philanthropic, charitable or religious purposes.

### Pending Amendments Before Senate and House.

The House Bill now pending before the Senate Finance Committee substitutes for the tax imposed by the foregoing Acts an estate duty of precisely similar character but with a schedule of graduated rates very heavily increased, reaching a maximum rate of forty per cent. upon all amounts by which the net estate exceeds $10,000,000.

We are informed that the Senate Committee has before it an amendment which is stated to have been tentatively agreed upon by that Committee and which provides a substitute for the estate tax of the House Bill.

This substitutes for the estate tax under existing law an inheritance tax similar to that in force among the states generally. Instead of imposing a single tax upon the transfer of the whole estate, with a schedule of rates based upon the aggregate amount of the whole estate, it imposes a tax upon the several transfers to the respective distributees or legatees, the rate of the tax in each case being determined by the amount passing to the transferee.

Neither under the pending House Bill nor under the amendment above mentioned pending before the Senate Committee is there any provision for the exemption of gifts for educational, philanthropic, charitable or religious purposes.

Another amendment is pending before the Senate Committee which adopts the theory of the Senate Committee amendment above mentioned, graduating the tax according

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to the amount passing to each legatee or distributee and containing a schedule of progressive rates reaching the rate of twenty-five per cent. on all amounts passing to any distributee in excess of $2,500,000.

This last proposed amendment contains an exemption of gifts to religious, charitable, scientific, literary or educational purposes to an aggregate amount not exceeding fifteen per cent. of the value of the estate, and it provides, in substance, that if the total amount of charitable gifts shall exceed fifteen per cent. of the value of the estate the several charitable legatees shall share proportionately in the exemption of the fifteen per cent. of the whole estate.

### Previous Amendments.

The general adoption of this system of taxation among the States is comparatively recent. Pennsylvania was the first State to resort to it in 1826, followed by Maryland in 1844, and North Carolina by the enactment, in 1846, of a law which was repealed in 1883. At the close of the Civil War inheritance taxes were in force in only four States. Thirty years ago they were in force in only six States. In recent years, however, one State after another has resorted to this method of raising revenue, so that in 1917 there were only five States which had not adopted it.

It has never become a part of the settled policy of taxation of the Federal Government. Congress first imposed a legacy tax in 1797, which was repealed five years later, in 1802. It has since been twice resorted to as an extraordinary war measure, once in the Civil War by the passage of the Act of 1862, which was repealed in 1870, and again in the Spanish War, by the Act of 1898, which was repealed in 1902. Resort to it was again had by Congress during the present World War by the passage of the Act of September 8, 1916, above referred to.

### American Gifts to Education and Philanthropy.

The period which has elapsed since the Civil War is that which has witnessed the wonderful growth and development of educational, philanthropic, charitable and religious institu-

tions in the United States—a growth and development created, fostered and encouraged by gifts and legacies for those purposes, such as are without parallel in any other country or in any other period. In other countries, universities, colleges, libraries, museums of science and art, hospitals and other forms of educational and philanthropic work have been in large degree carried on by the State. In this country substantially all of their great endowments, and by far the larger portion of their support, have come from private gifts and legacies. The making of gifts for such purposes has become a confirmed habit of the American people, and may be properly characterized as amounting to a voluntary self-imposed tax upon a vast number of people who are interested in such objects and able to contribute to them in large or small measure. It is to be remembered that it is not only the rich who give, and it is not only large estates that produce legacies for these purposes. Small gifts from persons of moderate means and small legacies from estates of moderate size amount in the aggregate to a vast sum.

These gifts from living individuals and these legacies from those who have passed away have, in large measure, relieved the State from burdens which in other countries are mainly sustained through taxation, and it cannot be questioned that this sustained and growing habit of giving has had an enormous effect in stimulating and keeping alive the interest of the people of this country in educational, philanthropic and charitable work.

## Unfavorable Effects of Existing Law.

Any legislation which would have the effect of discouraging this habit of giving for public purposes would be most unfortunate and surely opposed to the public interest, and any legislation which would practically render impossible the continuance of such giving would be a public calamity.

While the existing Federal Estate Tax Laws do not in terms impose a tax upon bequests for educational, charitable and religious purposes, they do, in effect, tax all such bequests, since the tax is imposed upon the whole estate and the rate of the tax is measured by the size of the estate. It is not to be



forgotten that every estate is called upon to bear not only the Federal Estate Tax, but, except in a very few jurisdictions where such laws do not exist, the inheritance tax of the State in which the decedent is domiciled, and in many instances an additional inheritance tax in other States in which are organized corporations whose stocks are owned by the non-resident decedent or in which is located tangible property of the decedent. In the case of large estates paying a very high rate of tax, there is to be considered also the very material additional burden involved in the loss incident to the forced liquidation of assets within a limited period, for the purpose of raising the cash required to pay the tax. Under the Federal Estate Tax Law this must be accomplished within a year from the decedent's death.

The result of all this is an enormous burden upon the estate; and as the natural desire of every man is to make, so far as he is able, proper and adequate provision for his family and those dependent upon him, bequests for public charities are those which every testator will feel that he must cut down in order to meet these great burdens.

Such considerations have resulted in a general policy in favor of the exemption of such bequests from inheritance taxes, even under the much more moderate rate of taxation generally imposed by the legislation in force prior to the passage of the Federal Estate Tax Act.

## Enlightened Public Opinion.

The enlightened public opinion of the country has been shown to be overwhelmingly in favor of the policy of exempting such bequests from inheritance taxes. A very great majority of the States which have adopted such taxes have provided in their laws, in one way or another, for the exemption of such bequests, as shown by the summary of the legislation on the subject herewith submitted.

Congress itself has recognized the wisdom and soundness of such a policy. The original Inheritance Tax Act of the Spanish War contained no such exemption, but shortly afterwards public opinion made itself felt and Congress passed an Act amending the Spanish War Revenue Act so as to exempt all such public bequests.

## Resources of Our Educational and Philanthropic Institutions Impaired by the War.

Every reason which could have been urged in favor of such an exemption under the conditions which existed in this country at the time of the Spanish War applies with far greater force to the conditions which confront us today. For nearly three years a war of unprecedented magnitude brought to many nations an amount of suffering such as has never before been known in history. During that period we were not a party to it and we were thus spared the suffering which others have undergone, but the people of the United States did their part toward the relief of the sufferers in other nations. Throughout the whole country their hearts were stirred and their sympathy aroused and they responded generously to the appeals made to them. Of course, this impaired their ability to maintain their current contributions to educational and charitable works at home, and all our institutions felt this narrowing of their resources.

Later the United States became a party to the war, and instead of being called upon only to relieve the suffering among foreign nations, the people of this country were called upon to perform, in addition, a similar service for their own. All have borne cheerfully the burdens necessary for the prosecution of a war carried on in defense of civilization itself, but these burdens have necessarily impaired the power of giving. Incomes have been reduced through heavy taxation; contributions for the comfort and well-being of our own troops, the enormous sums raised for the American Red Cross and other forms of activity for the relief of suffering—all these have curtailed enormously the power of contributing to the general support of charity from current income, and our educational, philanthropic, charitable and religious institutions have suffered in consequence a deplorable diminution in their income from this source.

Now the war has practically come to an end, but the calls upon the generosity of our people have not ceased, and will not cease, with it. In the period of reconstruction upon which we are now about to enter there will be a vast amount of suffering to be relieved and an enormous work of repair and restoration to be carried on. It is not to be doubted that the American people will respond as generously to these demands as they have to those of the past. Peace will result in some lowering of taxes, but the burden of taxation will still be very heavy, and the ability to bear that burden will be greatly impaired by the reduction of industrial and business profits which will certainly occur during the unsettled conditions following peace. It must be manifest to everyone that during this period all charitable, philanthropic and religious institutions will suffer greatly through the inability of the people to contribute out of income to their support, and that their main reliance for their maintenance, growth and development must be upon charitable legacies and bequests.



## Necessity of Repeal and Exemption.

It might well be urged, now that the war has ended and taxation is to be reduced, that one of the most appropriate items of reduction would be the *entire repeal of the estate duty.* That system of taxation has never been a part of the settled policy of the Federal Government. It has been resorted to by that Government only four times during its existence and then as an emergency measure and for brief periods only. In the meantime it has become a part of the settled policy of the States for the raising of their revenues. Now that the emergency which called for the imposition of this tax by the Federal Government has passed, why should not the Federal legislation imposing it be repealed?

However that may be, *we are here to urge not the repeal of the estate tax, but the exemption under it of bequests for charitable purposes.* The result of such an exemption would be practically negligible, so far as regards the amount to be raised by the Government. It is not every will that contains charitable bequests, and taking the aggregate value of all property passing upon death, whether by will or by intestate law, the proportion bequeathed to charity is so small that its exemption from this tax would indeed be negligible from the point of view of the raising of revenue, whereas, to the institutions concerned it is a matter of most vital importance. And

here, for the moment, let us ask what is the argument on the other side. Why should not these charitable bequests be exempt? Do they not go to the maintaining of institutions which are founded and carried on for the public benefit? Are they not a self-imposed, voluntary tax upon those who contribute them for the support of institutions which it would otherwise be the duty of the Government to maintain? It has been suggested that if they are exempted the exemption would enable the testator to evade the tax by making such exempt gifts to charity. But it is manifestly absurd to say that a man would make a gift to an exempt charity in order to escape payment of a tax thereon to the Government, when he is giving voluntarily the whole substance of the gift. He saves nothing by the exemption. It enures in no degree to his benefit. He makes the gift. If a tax is imposed it is not upon him. The burden falls upon the charity.

One of the amendments pending before the Finance Committee provides for an exemption of testamentary gifts to charitable, educational and religious uses to an aggregate amount not exceeding fifteen per cent. of the value of the whole estate of the testator.

In the case of small estates, where necessarily the great bulk of the testator's property must be left to his family for their support, this is well enough, for in such cases it is perhaps unlikely that the total gifts to charity would exceed this percentage, but the case of large estates is very different. In not a few instances of this class the testator will deem a comparatively small percentage of his estate sufficient to provide amply for the support of his family, and will therefore desire to leave to charitable purposes a much larger proportion of his estate than fifteen per cent., and in such cases the proposed limitation would very seriously affect the gifts to charity.

Upon what theory can such a limitation be justified?

Manifestly it must tend to discourage the making of liberal charitable gifts, or, if they are made will impose a heavy burden of taxation upon them.

Are we, at this late day, to abandon the principle of liberal individual giving under which our great educational and charitable institutions have reached their present stage of



growth and development—a principle which in its practical application has been of such undoubted benefit to the moral character of our people and which has increased their charitable inclination, giving them an increased interest in the charities to which they have contributed? Are we to add to the agitation of today for Government ownership of all sorts of public utilities, a movement for the substitution of Government support of educational and charitable institutions, through compulsory taxation, for the existing system of maintaining them through the voluntary contributions of the people?

If we are not to make this fundamental change in public policy, why should we adopt a principle of taxation the inevitable result of which must be the discouraging of such voluntary contributions for the sake of securing for the Government a comparatively insignificant amount of revenue?

## Operation of the Existing Law on the Russell Sage Foundation.

A striking example of the heavy burden to which charitable, educational and religious bequests are subjected by these Federal Laws is afforded by the very recent case of Mrs. Russell Sage.

This lady, who resided in New York, inherited a very large estate from her husband, and made, during her lifetime, many important contributions to charity and education.

She died only a few days ago, and on November 14, 1918, while this present memorandum was under preparation, a statement of the provisions of her will was published.

We desire to call the attention of the Committee to this case, as it shows the practical operation of these laws in a specific instance which has actually occurred.

In the published statement it is said that each of the shares into which the residuary estate of Mrs. Sage is divided is worth approximately $800,000. Upon this basis, the whole estate would be of the value of about $51,920,000.

The testatrix left no children surviving her. She bequeathed to her brother and to her nephews and nieces and to several individuals sums amounting in the aggregate to $8,480,000.

She then gave certain pecuniary legacies to thirty-one

different institutions of a charitable, educational or religious character, including hospitals, institutions for the care and relief of women and children, colleges, churches and religious institutions. These pecuniary legacies, which range from $10,000 to $200,000, amount in the aggregate to $1,840,000.

She then directed that her residuary estate be divided into fifty-two equal parts and bequeathed one or more of such parts to each of thirty-six charitable, educational and religious institutions situated in various parts of the country. These included a number of universities, colleges, museums of art, hospitals, organizations for the relief and care of women and children, missionary and Bible societies. The largest share of the residuary estate left to any one of these institutions was that given to the Sage Foundation, which had been organized in memory of her husband. This amounted to $5,600,000. To ten institutions she bequeathed $1,600,000 each; to one institution $1,200,000; to twenty-three institutions $800,000 each; and to one institution $400,000.

The will was executed before the enactment of the Federal Estate Tax and all taxes of this character would be payable out of the residuary estate.

All the gifts to charity and education are exempt from the New York State Inheritance Tax, which would, therefore, apply only to the legacies to the brother and other individuals and would amount to approximately $450,000.

*The Federal Estate Tax, under the statutes now in force, would amount to $12,202,500, making total taxes of $12,652,500 payable out of the residuary estate of $41,600,000.*

But, in order to determine the real amount of the burden, another element must be taken into consideration. Under the existing law the tax is due from the executors one year from the testator's death, and payment must be made in cash. If not paid within ninety days after the expiration of the year heavy penalties are incurred. Of course we have no information concerning the nature of the assets of this particular estate, but assuming that it consists of various classes of investment securities such as are ordinarily held by people of means, there would certainly be a heavy loss incurred through the enforced liquidation necessary to raise in cash so large a



sum as twelve and a half millions of dollars out of an estate of approximately fifty-two millions, within a year or fifteen months.

It is to be remembered that the value of the estate is fixed for the purposes of this tax by taking the market value of the securities on the day of the testator's death, as shown by actual market transactions, or, in case no sale is recorded on the public market on that date, then by taking the bid price.

For many securities of undoubted value, however, the market is extremely limited. This is true of many perfectly good railroad stocks and bonds, of the securities of many prosperous industrial enterprises and generally of securities of all financial institutions. One or two hundred shares may readily sell at a good price when it is absolutely impossible to dispose of any considerable amount of the same stock at anything like that price. Everyone who is at all conversant with financial market conditions knows that this is absolutely true in normal times, and it is certainly no less true in times like the present when the future course of the security market is so uncertain, and it is probably a very conservative estimate to say that under normal market conditions the realizing of twelve and a half millions in cash through sales of the assets of an estate of fifty-two millions, within the period of twelve or fifteen months, would involve a loss of not less than seven per cent. upon the value of the estate. In times like the present the loss would be much greater, and even in normal times this estimate would be a very inadequate measure of the real loss if the estate had a large amount of property for which there is a very limited and slow market, as, for instance, a large amount of real estate.

Taking, then, this additional element into consideration, and applying the existing law to Mrs. Sage's estate, we have the following results:

*The total taxes, as above stated, would be $12,652,500. To this should be added $3,643,400, representing the loss on liquidation, calculated at seven per cent. on the appraised value of the estate. The total of these two items is $16,295,900, which is the total burden directly resulting from taxation which must be borne by the residuary estate.*

*Under the Existing Law, this $16,295,900 will be taken from the Educational, Philanthropic and Religious institutions, to which it was bequeathed, and applied to the current expenditures of the Government.*

*As the residuary estate bequeathed for charitable, educational and philanthropic purposes amounts to $41,600,000, the imposition of this burden results in a net diminution of about forty per cent. in the amount of the residuary estate bequeathed to each of these institutions.*

Respectfully submitted,

Committee of New York Citizens in re Exemption of Educational, Philanthropic and Religious Bequests from Federal Taxation.

NICHOLAS MURRAY BUTLER, President of Columbia University.

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CLEVELAND H. DODGE, Trustee of the New York Public Library and of The American Museum of Natural History.

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Per Chairman,

Henry Fairfield Osborn

President of The American Museum of Natural History.

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